

Module III: Learning to Manage Debt

Summary: *In the first two lessons, you learned the importance of setting financial goals and establishing a budget. In this lesson you will build upon that knowledge as you learn to manage debt. Debt management is the process of relieving a financial obligation through personal financial planning. There is one simple key to staying out of debt-- spending only within your means. However, many people forget this idea and find themselves having to manage debt. If you are having difficulties organizing your finances and/or find yourself in debt, then you are not alone. With all of the options for credit today, more and more people are finding themselves in debt. Debt can often be a serious problem, especially for soldiers, if it is not managed properly. For members of the military, severe indebtedness can lead to forfeiture of earnings, loss of a security clearance and possible punitive action. These reasons, along with a promising financial future, are all good motivators to reduce or eliminate debt as soon as possible. It is important to invest your money if you want to increase your wealth. However, it is not wise to invest money while carrying any kind of debt—outside of continuing your emergency fund. Therefore, debt management is the most important step toward becoming financially responsible and successful.*

Personal Financial Status

You must understand your own financial status before being able to successfully manage debt. Although the previous lessons discussed personal finances and budgeting, we will now go more in-depth. You must know where you stand before you allocate funds to relieve debt. There are some basic questions that you must ask when facing debt.

- 1) **How much income do I have after necessary expenses?** It is important to know how much money you can afford to allocate toward debt relief each month. This number can obviously be adjusted by reducing the amount spent in other areas. This type of personal financial planning was addressed in the prior lessons.
- 2) **To whom do I owe money?** You must do a complete review of your financial situation in order to determine all of your obligations.

This includes examining credit card bills, loan payments, rent, utilities, and any other expenses you incur. Nearly every company deals with debt in basically the same way. When you owe money to a company, there are stiff penalties and fees for not making payments on time.

- 3) **How much money do I owe and what is the interest rate?** This is probably the most important question to answer. Once this question is answered, you can discuss viable solutions to relieve these financial burdens.

The Two Major Types of Debt

Although there are many ways for individuals to get into debt, we will focus on the two that most often affect soldiers -- credit card debt and debts from loans. Before we discuss how to relieve these types of debt, we will discuss how people get in trouble with credit cards and loans.

Credit Cards

You are young and new to the world of credit. You continually receive credit applications in the mail that look great. WOW—a \$5,000 limit. Do you know what I could buy with \$5,000? That is the kind of thinking that gets so many young soldiers into trouble. Remember, if it looks too good to be true, then it probably is. Credit cards work on the basic principle of “buy now and pay later.” Credit cards are very convenient and safe for instances such as large purchases, reservations and emergencies. However, they can also be very dangerous when abused. Charging an item does not mean that it is free. Items charged often actually cost more than the original price due to interest payments and other assorted fees imposed by the credit company. You may be wondering how credit cards can be such bad things if nearly everyone has at least one. Well, credit is not a bad thing if it is used properly. It is the improper usage of credit cards that causes most of the problems with credit cards.

Choosing a Credit Card that Best Suits You -- Before you sign up for a credit card it is important to choose the one that best suits you. Once you sign up for a credit card, you have entered a legal contract

stating that you agree to the terms that the company has set. This includes your agreement to the stated interest APR (Annual Percentage Rate) and to pay any annual fees, late fees, or charges. You want a low APR and no annual fee. APR's can range from 8% to 25%. Although Gold and Platinum credit cards often have a lower interest rate, they usually also require a large annual fee. A later demonstration will show why choosing the right card is so important. This is why it is crucial that you research all available options for credit cards before signing on the dotted line.

Using your Credit Card -- Credit cards basically work in the following manner. You make a purchase using your credit card. Then the credit company sends you a bill at the end of the month reflecting the past month's activities. This bill will include at a minimum- a statement of your charges for the past month, your total balance, the minimum payment due, the payment due date, and your monthly interest rate. It is your responsibility to then make a payment to the company that will show up on the next month's bill. Be sure to keep copies of all correspondence with your credit company in order to ensure that you have documentation for all payments in order to answer future questions.

Ways to Avoid Credit Card Trouble

1) Renegotiate with the credit companies -- Call your credit card companies and inform them that you desire a lower interest rate. Inform them that you are having trouble with your finances and ask them to lower your rate. The key is to be polite and to inform them that you have been receiving other offers to consolidate your debt.

2) Pay off as much as you can -- DO NOT pay only the minimum amount due each month. If there is only one thing that you remember from this lesson it should be the following — you must pay off your credit cards before investing money (again, outside of what you have in your emergency fund). Since credit card interest rates on unpaid balances usually range from 15% to 20%, it is definitely in your best interest to pay the maximum amount that you can afford each month. The best way to avoid trouble is to pay off your balance in full every month. If you make the minimum payment, then interest will be charged.

3) Move your existing balances to a card with a lower APR --

Another option is to take a look at all of the credit cards that you have and then transfer all of your balances to the card with the lowest APR. This would consolidate your debt to the lowest interest rate. It is not very smart to pay 20% interest on some debt when you could be paying 12% instead.

4) Use any savings that you have to pay off debt -- Although no one wants to spend his/her savings on credit card debt, this option may be necessary. In a typical savings account, your money will make around 3%. Your credit card interest rate will be much higher than 3%. By examining this, it is a good decision to pay off credit cards at 15%, rather than make a measly 3% interest off of the same money. The key here is to keep your emergency fund at a level that will allow you to pay unanticipated expenses without having to go further into debt.

5) Borrow money from a cheaper source -- Sometimes in order to pay off debt it takes drastic measures. One course of action may be to borrow money from family or friends to pay off credit debt. You can offer them a lower interest rate than your credit card. This is a tough choice, because you do not want to owe money to your loved ones for a long period of time. Also, consider that this option could cause some unnecessary family strife.

6) Seek help from the experts -- There is professional help available to help you sort out your debt problem. There are people in Army Community Service (ACS) or possibly within your military organization who have debt management experience. Do not be afraid to ask your chain of command for assistance. However, do not wait until you face bankruptcy to seek advice. If you do not feel comfortable seeking help from those around you, then there are also civilian debt management personnel and websites available to assist.

7) Remember that Government Credit Cards are for official use only -- You may only use government credit cards for authorized expenses during Permanent Change of Station (PCS) moves and Temporary Duty (TDY) trips. Authorized expenses will be stated in your orders. Abuse of the Government Credit Card is one type of

credit card trouble that you do not want to get into. In addition, you can be punished for using your government card for personal expenses.

Examples of Credit Card Usage

The following example illustrates the fairly common usage of a credit card. Assume this is a statement sent by the credit card company at the end of January. The user's payment would be due approximately 15-30 days later. This example shows the different payment options that the user has. This example uses a 15% annual interest rate, which is relatively low.

Date of Purchase	Location of Purchase	Amount
2-Jan-01	Bob's	\$200
6-Jan-01	Ralph's Stereos	\$500

Interest Rate (APR) 15% divided by 12
to make it monthly = 0.125

Total Balance	\$700
Minimum Payment	\$50

1. Situation if you pay minimum balance due -
 $\$700 - \$50 = \$650$
 $\$650 + (650 \times 0.125) = \658.12 Amount due -next statement

Without charging anything the next month, you nearly **owe** more money than originally charged!!!

2. Paying more than the minimum balance due-
 $\$700 - \$400 = \$300$
 $\$300 + (300 \times 0.125) = \303.75 Amount due - next statement

Without charging anything the next month, you will owe a good portion of what you originally charged!

3. Paying off the full balance-
 $\$700 - \$700 = 0$
 $0 + (0 \times 0.125) = 0$ **\$0** Amount due - next statement

This is the **IDEAL** situation! Carrying a zero balance should be any credit users goal.

4. Paying nothing on a statement-
 $\$700 - \$0 = \$700$
 $\$700 + (700 \times 0.125) =$
\$708.75
\$708.75 + any late fees imposed
could amount to up to \$75
\$783.75 Amount due next statement

This is obviously the worst of the choices. Late fees are a killer!

Loans

The second major area that often gets soldiers into debt is loans and some of the “scams” that can accompany them. Loans offer the same quick fix that credit cards do--cash now and pay later! Soldiers often make the mistake of signing up for loans that end up costing them more than they anticipated in the future. As with credit cards, if it sounds too good to be true, then it most likely is! There are many types of loans available to soldiers. Auto loans and fast cash loans are the two most common. Loans operate under similar principles as credit cards. An organization lends you money up front and then expects it to be paid back over a specified period of time at a stated interest rate. When these periodic payments cannot be made, the trouble begins. Just like with credit cards, it is imperative that you research options before making any rash decisions. Before you take out a loan, there are many things that you must consider.

1) **Is this loan absolutely necessary?** You must ask yourself if getting a loan is the only financial option left. The purpose of the loan is key.

2) **Is the purchase that you need the loan for absolutely necessary?** New cars and fancy toys are not loan worthy unless your financial situation is stable and will continue to be so. If you cannot afford to purchase an item, either do not buy it, or WAIT until you have the money to pay for it.

3) **Is this the best loan that I can get?** Have I checked into multiple loan options? Banks often offer better rates than privately owned companies just outside the gate. We will later discuss why these companies are so anxious to get you to sign on the dotted line.

4) **What is the deal with the interest rate?** The interest rate should be fixed over a period of time, unless it is a variable rate loan and terms are stated up front. The lender should not be able to change the interest rate without your consent. A changing interest rate deal is a scam that can often lead to problems down the road.

5) **Over what period of time will you have to pay back the loan, and can you afford to do so?** Do you really want to pay back \$500

over three years? Does that make any sense? You want to negotiate for a term of payment that suits the amount of money you are borrowing. Remember, the longer you take to pay back the loan, the more interest you will pay.

6) Is the company offering the loan a reputable institution? It is important to trust the loaner of the money. If you think that “Biff’s Pawn Shop” sounds kind of sketchy, then do not borrow money from them. If they may pack up and move at anytime, do not deal with them.

7) What kind of collateral, if any do you have to give the lender? Lenders will sometimes require you to offer something valuable as good faith that you will pay back the loan. Jewelry is a common form of collateral. Some “just outside” the gate lenders require an auto title when signing for a loan. The deal is that you keep the vehicle, but they keep the title until the loan is paid back. This is not a very wise move because you will end up losing your car if you are unable to pay back the loan. These auto title loans are not always a scam, but they are almost always an unwise move.

Loans are not always bad. People take out loans all the time for major purchases such as houses and cars. As with all financial documents, do not forget to make copies of all loan papers and agreements. It is not smart to take out loans for unnecessary items if you do not have a large income. You must budget your finances and include any loan payments that you would have to make before signing up for a loan. If you include a loan and your budget leaves you only \$50 for miscellaneous items, then a loan is probably not a good idea.

Examples of Loans

The following are examples of loan options and payments that a soldier could choose. The initial amount borrowed, the interest rate, and the total amount spent are the key areas of each example. These examples show how the interest rate affects the total amount paid.

Example 1-

Initial Amount Borrowed \$1,000

Annual
Interest
Rate 15%

Monthly Payments over a year
would be \$90.26 monthly

This would make your total amount paid = **\$1083.12**

Example 2-

Initial Amount Borrowed \$3,000

Annual
Interest
Rate 15%

Monthly Payments over a year
would be \$270.77 monthly

This would make your total amount paid = **\$3249.24**

Example 3-

Initial Amount Borrowed \$3,000

Annual
Interest
Rate 20%

Monthly Payments over a year
would be \$277.90 monthly

This would make your total amount paid = **\$3334.80**

Example 4-

Initial Amount Borrowed \$10,000

Annual
Interest
Rate 10%

Monthly Payments over a year
would be \$879.16 monthly

This would make your total amount paid = **\$10549.92**

Summary

With the knowledge you have gained from this lesson, you should be able to successfully manage debt. Remember to consolidate your debt in order to pay it off with as little difficulty as possible. Credit cards and loans can really get you into trouble if you do not make smart decisions. Your personal financial future just may depend on your ability to stay out of unnecessary debt. If you are already having trouble managing your debt, this guide should help you find your way back to solid financial ground.

For more information on understanding and managing debt, contact your local Army Community Service (ACS). ACS has financial counselors that stand ready to assist you in all areas of personal financial management.

Appendix: Soldiers and Sailors' Civil Relief Act

The Soldiers and Sailors' Civil Relief Act (SSCRA) of 1940 is a little known statute that provides an extensive amount of protection for active duty members of the military. The SSCRA provides some protection regarding loan interest rates and repayment of debts for debts that arose before the soldier entered active duty and if the difference between his prior civilian income and his military pay has substantially harmed his financial position. Although it does not apply to everyone, this act may help some soldiers to relieve some of their debt burden. The intention of this statute is to postpone/suspend specific civil obligations while service members are active duty. Reservists and members of the National Guard are also entitled to the benefits, while on active duty status. The SSCRA benefits soldiers in many ways, but this discussion is limited to debt management.

MAXIMUM RATE OF INTEREST – This clause of the SSCRA could be the most beneficial to most service members. If, prior to entering active duty service, a member incurs a loan or obligation with an interest rate in excess of 6%, the member will, upon application to the lender, not be obligated to pay interest in excess of 6% per year. This relief applies during the period of active duty service unless a court finds the member's ability to pay has not been materially effected by military service.

This statute only applies to debt incurred prior to entry into the service. There is no relief on interest for debts incurred after entry onto active duty. In fact, many credit card companies will refuse any attempt to invoke this provision any part of the credit card debt IF the credit card has been used after entry onto active duty. Their rationale is that use of a credit card after entry onto active presumptively establishes that entry onto active duty did not materially affect the service member's ability to pay his debts.

If you have questions concerning the SSCRA, you should visit your local military legal office or the following website for more information:

<http://www.jagcnet.army.mil/Legal>